

Message Text

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C O N F I D E N T I A L SEOUL 1835

HONG KONG FOR REGFINATT

E.O. 11652: GDS

TAGS: EFIN, ETRD, IMF, MTN, KS

SUBJECT: ROKG PLEASED WITH IMF CONSULTATIONS AND BULLISH ON
CURRENT ECONOMIC OUTLOOK

REF: SEOUL 1801

SUMMARY. ROKG OFFICIALS BELIEVE THEY SATISFACTORILY DEMONSTRATED TO THE RECENT IMF MISSION THAT THE ROKG HAS ITS BALANCE OF PAYMENTS AND INFLATION SITUATIONS IN HAND AND CAN STILL LOOK FORWARD TO A YEAR OF STRONG, EXPORT-LED GROWTH. RECENT DATA INDICATE CURRENT ROKG OPTIMISM OVER THE 1976 ECONOMIC OUTLOOK IS WARRANTED, BUT ALSO INCLUDE A FEW SIGNS THAT THE RECOVERY COULD BECOME TOO BOUYANT IF THE POSTURE OF GENERAL RESTRAINT IS NOT CAREFULLY MAINTAINED. SHOULD THE EVIDENCE INDICATE ANY SIGNIFICANT WEAKENING OF ROKG RESOLVE IN THIS REGARD BY THE TIME THE IMF MISSION RETURNS IN JUNE, WE ANTICIPATE THAT THE IMF WOULD TAKE A FORCEFUL STAND IN PRESSING FOR CORRECTIVE ACTION AT THAT TIME. END SUMMARY

1. ROKG OFFICIALS APPEAR TO BE GENUINELY PLEASED WITH THE OUT-
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COME OF THE RECENT IMF CONSULTATIONS REPORTED REFTEL, BELIEVING

THEY DEMONSTRATED TO THE MISSION'S SATISFACTION BOTH THAT THE ROKG IS CONFIDENTLY MANAGING ITS BALANCE OF PAYMENTS AND INFLATION SITUATIONS AND THAT KOREA CAN CONTINUE TO LOOK FORWARD TO A YEAR OF STRONG, EXPORT-LED GROWTH. RECENT INDICATORS SUPPORT THE CURRENT ROKG OPTIMISM, BUT ALSO SUGGEST THAT IMF CAUTIONS CONCERNING THE NEED TO BE PREPARED TO ADJUST POLICIES AS NECESSARY TO MEET THE BALANCE OF PAYMENTS AND INFLATION TARGETS WERE WELL-TAKEN.

2. EVIDENCE CONTINUES TO MOUNT THAT EXPANSIONARY FORCES IN THE ECONOMY HAVE CONSIDERABLE MOMENTUM, CHIEFLY PROPELLED BY CONTINUED STRONG EXPORT DEMAND. PRELIMINARY INDICATIONS ARE THAT MONTHLY EXPORT TOTALS AVERAGED IN THE \$500 TO \$550 MILLION RANGE ON A SEASONALLY ADJUSTED BASIS FOR JANUARY AND FEBRUARY. SEASONALLY ADJUSTED EXPORT LETTER-OF-CREDIT (L/C) ARRIVALS, A GOOD FORECASTER OF FUTURE EXPORT TRENDS, WERE RELATIVELY STABLE AT ABOUT \$500 MILLION A MONTH FOR THE NINE MONTHS ENDING JAN. 1976 BEFORE SOARING TO AN ASTONISHING \$692 MILLION (PRELIMINARY) IN FEBRUARY.

3. GAINING A FURTHER SEASONALLY ADJUSTED 1.2 PERCENT OVER DEC., THE JANUARY INDUSTRIAL PRODUCTION INDEX IS 28 PERCENT ABOVE A YEAR EARLIER. THE RECENTLY REVISED "BUSINESS WARNING INDICATOR", AN INDEX OF LEADING INDICATORS, HAS RISEN SHARPLY SINCE SEPT., HOWEVERING AT THE 1.7 MARK FOR JAN. AND FEB. A LEVEL ABOVE 1.5 IS CONSIDERED TO BE A REFLECTION OF VIGOROUS ECONOMIC ACTIVITY. THE WELL-REGARDED KOREAN DEVELOPMENT INSTITUTE (DCI) RECENTLY FORECAST THAT 1976 FIRST QUARTER REAL GNP WILL BE 12 PERCENT HIGHER THAN A YEAR EARLIER WHICH WOULD MEAN THAT ROUGHLY A THIRD OF THE GOVERNMENT'S TARGETED FIGURE OF 7 TO 8 PERCENT GROWTH IN REAL GNP FOR 1976 WOULD BE ACHIEVED IN THE FIRST QUARTER.

4. MOST OBSERVERS BELIEVE A SUSTAINED RECOVERY IS WELL UNDERWAY. A GROWING ISSUE IS WHETHER THE ROKG WILL BE WILLING TO CONTAIN THESE EXPANSIONARY FORCES SUFFICIENTLY TO ASSURE ACHIEVEMENT OF ITS TARGETED 1976 GOALS OF A BALANCE ON BASIC ACCOUNT FOR ITS BALANCE OF PAYMENTS AND AN INFLATION RATE OF 13 PERCENT OR LESS (GNP DEFLATOR BASIS). TO THE EXTENT STRONGER GROWTH CAN BE ACHIEVED BY EXCEEDING THE \$6.5 BILLION EXPORT TARGET, AND ASSUMING THERE IS STILL SUFFICIENT SLACK IN THE ECONOMY TO ABSORB

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THAT ADDITIONAL DEMAND, THE IMPACT OF A HIGHER THAN PROJECTED GROUP RATE ON THE BALANCE OF PAYMENTS AND INFLATION TARGETS COULD BE LARGELY NEUTRAL, AND POSSIBLY EVEN FAVORABLE, AT LEAST FOR THE BALANCE OF PAYMENTS. HOWEVER, PRESSURE ON THE ROKG FROM BUSINESS CIRCLES TO EASE UP THE TIGHT REIN ON MONEY AND CREDIT IS INTENSIFYING. WHILE TWO MONTHS HARDLY CONSTITUTE A TREND, 1976 DATA THROUGH FEB. INDICATE EXPANSION OF MONEY SUPPLY AND DOMESTIC CREDIT AT SEASONALLY ADJUSTED ANNUAL RATES IS CURRENTLY

33 PERCENT AND 48 PERCENT RESPECTIVELY. THESE RATES COMPARE TO FULL-YEAR TARGETS OF 20 PERCENT FOR MONEY SUPPLY AND 26 PERCENT FOR DOMESTIC CREDIT. HOWEVER, IT SHOULD BE NOTED THAT JAN-FEB EXPANSION FOR DOMESTIC CREDIT FOLLOWS IN THE WAKE OF EXCEPTIONAL RESTRAINT OVER THE LAST HALF OF 1975.

5. SCATTERED PRELIMINARY DATA INDICATE THAT BOTH BALANCE OF PAYMENTS AND INFLATION PERFORMANCE IN JAN AND FEB GENERALLY CONTINUED THE FAVORABLE TRENDS THAT EMERGED IN THE SECOND HALF OF 1975. INITIAL FIGURES SHOW A COMBINED JAN.-FEB. TRADE DEFICIT OF \$111 MILLION ON A FOREIGN EXCHANGE (KFX) BASIS, I.E., EXPORTS, F.O.B.B., AND IMPORTS, C.I.F., BUT EXCLUDING FOREIGN LOAN AND INVESTMENT FINANCED IMPORTS AND A FEW OTHER MINOR CATEGORIES OF BOTH EXPORTS AND IMPORTS. ALTHOUGH THIS DEFICIT CONTRASTS WITH A CONSISTENT MONTHLY SURPLUS OR VIRTUAL BALANCE DATING BACK TO LAST MAY, IT IS LARGELY EXPLAINED BY THE NORMAL SEASONALLY LOW EXPORT LEVELS IN JAN. AND FEB. AND IS A MARKED IMPROVEMENT OVER THE DEFICIT OF \$492 MILLION RECORDED FOR THE SAME TWO MONTHS A YEAR AGO. GROSS FOREIGN EXCHANGE RESERVES DROPPED SLIGHTLY DURING JANUARY FROM THE DECEMBER 31 LEVEL OF \$1,542 MILLION (REVISED), BUT REBOUNDED TO \$1,555 MILLION AS OF FEBRUARY 29.

6. RECENT KFX IMPORT LICENSING TOTALS INDICATE IMPORT DEMAND IS GAINING MOMENTUM AND SUGGEST THAT THE PERIOD OF ABNORMALLY RESTRAINED IMPORT LEVELS MAY BE COMING TO A CLOSE. FOR THE FIVE MONTHS ENDING WITH FEB., SEASONALLY ADJUSTED KFX LICENSING HAS AVERAGED \$564 MILLION PER MONTH, OR ABOUT \$28 MILLION A MONTH HIGHER THAN THE COMPARABLE AVERAGE FOR EXPORT L/C ARRIVALS. THIS MARKS A REVERSAL OF THE PATTERN OVER THE SECOND AND THIRD QUARTERS OF 1975 WHEN ADJUSTED MONTHLY EXPORT L/C ARRIVALS WERE TOPPING ADJUSTED KFX LICENSING BY AN AVERAGE OF \$50 MILLION PER MONTH. WHILE A REVIVAL OF MORE NORMAL IMPORT DEMAND WAS ANTICIPATED IN THE ROKG'S FORECAST OF AN OVERALL 1976 VISIBLE TRADE

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DEFICIT OF ROUGHLY \$900 MILLION ON A BALANCE OF PAYMENTS BASIS, THESE DATA INDICATE THE NEED FOR CAREFUL MONITORING OF THE STRENGTH OF THIS REBOUND.

7. PRICE DATA THROUGH FEB. SHOW THE WHOLESALE PRICE INDEX RISING AT A SEASONALLY ADJUSTED ANNUAL RATE OF 11 PERCENT OVER THE PAST EIGHT MONTHS WHICH INCLUDES A BULGE IN DEC. AND JAN. REFLECTING SHARP UPWARD REVISIONS IN SEVERAL KEY ADMINISTERED PRICES. THE COMPARABLE ANNUAL RATE FOR THE SEOUL CONSUMER PRICE INDEX IS 13 PERCENT, WITH MOST OF THE INCREASE OCCURRING IN THE FIRST HALF OF THE EIGHT-MONTH PERIOD. THESE FIGURES COMPARE TO 1976 TARGETS OF 10 PERCENT FOR WHOLESALE PRICES AND 12 PERCENT FOR RETAIL PRICES.

8. IN SUM, THE CURRENT ECONOMIC OUTLOOK APPEARS INCREASINGLY

FAVORABLE IN MOST RESPECTS, BUT WITH SOME WARNING SIGNS THAT THE RECOVERY COULD BECOME A LITTLE TOO BOUYANT. ROKG OFFICIALS ARE ADAMANT THAT THEY ARE CLOSELY MONITORING BALANCE OF PAYMENTS AND INFLATION TRENDS IN PARTICULAR AND FULLY INTEND TO MAINTAIN AN ADEQUATE DEGREE OF RESTRAINT. SHOULD EVIDENCE INDICATE ANY SIGNIFICANT WEAKENING IN ROKG RESOLVE BY THE TIME IMF MISSION RETURNS IN JUNE, WE WOULD ANTICIPATE THAT THE IMF WOULD TAKE A FORCEFUL STAND IN PRESSING FOR CORRECTIVE ACTION AT THAT TIME.
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